Banyan Tree Holdings Limited: Credit Initiation Report

iFAST Research Team ***Friday, 8 September 2017***

Debt Programme: S$700,000,000 Multicurrency Debt Issuance Programme

Issues	Maturity	Currency	Amount Issued	Payment Rank
BTHSP 5.750% 31Jul2018 Corp (SGD)	31/7/2018	SGD	70MM	Sr Unsecured
BTHSP 5.350% 26Nov2018 Corp (SGD)	26/11/2018	SGD	50MM	Sr Unsecured
BTHSP 4.875% 03Jun2019 Corp (SGD)	3/6/2019	SGD	125MM	Sr Unsecured
BTHSP 4.850% 05Jun2020 Corp (SGD)	5/6/2020	SGD	100MM	Sr Unsecured

Source: Bloomberg, iFAST compilations

Summary and Conclusion

Issuer Profile: Positive

- **We are initiating Banyan Tree Holdings Limited (BTH) with a Positive issuer profile**. BTH recently entered two important strategic partnerships with Accor SA (Accor) and China Vanke Co Ltd (Vanke), and we see these events as credit positive. In the near term, BTH will receive a capital injection of S$48m from the two companies. BTH has also disposed its China-based assets to a joint venture with Vanke for a consideration of ~S$90.1m. In addition, the company has granted Accor and Vanke options to purchase additional new equity in the company, at an exercise price to be determined at a later date.
- **We deem BTH's overall financial risk profile as *Significant* and its overall business risk profile as *Fair*.** Post-completion of its transactions with Accor and Vanke, we should see a significant reduction in the company's gearing. Assuming that Accor's convertible debenture gets converted into equity and both Accor and Vanke exercise in full their options for additional shares at S$0.60/share, we estimate BTH's consolidated net debt-to-equity ratio would improve considerably to ~0.4x from 0.7x in 2Q17.
- The BTH bonds have all posted a strong rally since early February, after the announcement of the strategic partnerships with Accor and Vanke. **We think that the current pricing has already factored in most if not all of the positives from the two deals.** As such, we have assigned a Neutral rating on all four of the BTH bonds. On a relative-value basis, we prefer the BTHSP 5.350% 26Nov2018 Corp (SGD) and BTHSP 4.850% 05Jun2020 Corp (SGD).

Company Profile

BTH is a manager and developer of premium resorts, hotels, residences and spas. The Group's primary business is centred on four brands—the well-recognised Banyan Tree and Angsana, and the recently established Cassia and Dhawa. BTH is listed on the Singapore Stock Exchange (SGX) since June 2006, and has a market cap of S$483m as at 7 Sep 17.

Banyan Tree holds a 65.75% stake in Laguna Resorts & Hotels Public Company Limited (LRH), which operates the integrated resort Laguna Phuket in Thailand. LRH is listed on the Thailand Stock Exchange with a market cap of THB 4.5 billion (S$182m). From its maiden property in Phuket, BTH has expanded to 25 countries on four continents. At the end of 2016, BTH owns or manages 40 hotels (19 with equity interest) with 37 under its own brands, and 3 under other brands—the Grand Luang Prabang, Laguna Holiday Club Phuket Resort and Maison Souvannaphoum Hotel.

BTH operates three main business segments:

• Hotel Investments

Relates to the 19 hotels (over 2,000 keys) whereby BTH has an ownership interest in. BTH's equity ownership interest in these properties ranges from minimally held stakes held under real estate private funds to a 100% equity interest. Among the 19 hotels, one was sold to CDL Hospitality Trust in January 2013 under a sale-and-leaseback arrangement. BTH has seemingly tilted toward an asset-light strategy in recent years, selectively taking equity interest in new properties (BTH held equity stakes in 14 of its 20 properties at the end of 2006), preferring instead to license out its brands and manage third-party owned assets. BTH's FY16 Analyst Presentation projects the company to have an equity interest in 33% of the hotels in its portfolio by 2020, compared to the 49% at present.

• Property Sales

Comprises two main segments—hotel residences and Laguna property sales. BTH's hotel residence business comprises the sale of villas or apartments which are part of hotel operations to investors under a compulsory leaseback scheme. Such residences are currently available in China, Indonesia, Mexico, Seychelles, Thailand and Vietnam. In 2016, BTH expanded its offering and launched Banyan Tree-branded apartments in Brisbane, Australia that are not part of hotel operations. Laguna property sales refer to the development and sale of properties which are standalone vacation homes that are within the vicinity of BTH resorts but are not part of hotel operations. Laguna properties are currently available for sale in Phuket, China and Indonesia.

• Fee-based Segment

BTH's fee-based business comprises hotel, fund and club management, spa and gallery operations, and design and other services. The company manages 21 resorts and hotels, and operates 64 spas, 77 gallery outlets and three golf courses in 25 countries. Besides managing hotels for other owners, BTH is also involved in the management of an asset-backed destination club and the management of hospitality real estate private equity funds. The Group's retail arm, Banyan Tree Gallery, sells branded gifts, spa products, indigenous or cultural handicrafts and souvenirs.

Quality of Management and Ownership *(Strong)*

BTH Group founders Mr Ho Kwon Ping and his wife Ms Claire Chiang led the executive management team. Together with Mr Ho Kwon Cjan, the brother of Mr Ho Kwong Ping, they owned a stake of 47.2% (including deemed interest) in BTH as at 16 March 2017. Mr Ho KwonPing is the Executive Chairman of BTH and is responsible for its overall management and operations. He is also the Chairman of LRH and Thai Wah PCL and serves as a non-executive director of Diageo Plc (listed on the London Stock Exchange).

Ms Chang pioneered the BTH Group's retail business. As Chairperson for China Business Development she focuses on acquiring new management contracts, and according to BTH's 2016 annual report she also provides guidance to strategic issues in organisational and human capital capability. In addition, Ms Chang chairs Banyan Tree Global Foundation, BTH's sustainability arm.

Mr. Ho KwonCjan is the Senior Vice President and Group Chief Designer involved in overseeing design and project teams in the architectural subsidiary of BTH. He has also been a Director of LRH since 2012, and prior to 2005, he was Joint Managing Director of LRH, a position he held from 1998. Mr Ho served as Vice Chairman of Thai Wah PCL between 1997 and 2003.

Qatar's sovereign wealth fund, the Qatar Investment Authority (QIA), owns 27.1% of BTH's outstanding shares. Bloomberg data shows that QIA first became a substantial shareholder of BTH in 2008.

Having completed the deals with Accor and Vanke (market cap of approximately USD 13.7 billion and USD 40.1 billion respectively), BTH is in partnership with two large and experienced corporates with strong financial backing. BTH should be able to glean some operational scale benefits from the partnerships with the two companies. In addition, BTH should benefit from Accor's sizeable presence in Europe, Africa, the Middle East and the Americas, and Vanke's local know-how as a nationwide real estate developer in China.

One issue we noted when assessing BTH's executive compensation is the "Founder's Grant" program, while entitles Mr Ho KwonPing to an amount equivalent to 5% of the profit before tax of BTH, for each financial year for a period of 10 years beginning from the financial year ended 31 December 2010. We find it hard to agree with the stated objective of the Grant, which "aims to secure the continuing commitment of Mr Ho to the Group and to reward him for founding, leading and building up the Group", when Mr Ho together with his wife already owned a stake of 38.5% in BTH.

Financial Analysis *(Financial Risk Profile)*

We see BTH's overall financial risk profile as ***Significant*** considering the below analysis and factors, and the quality of its management and ownership.

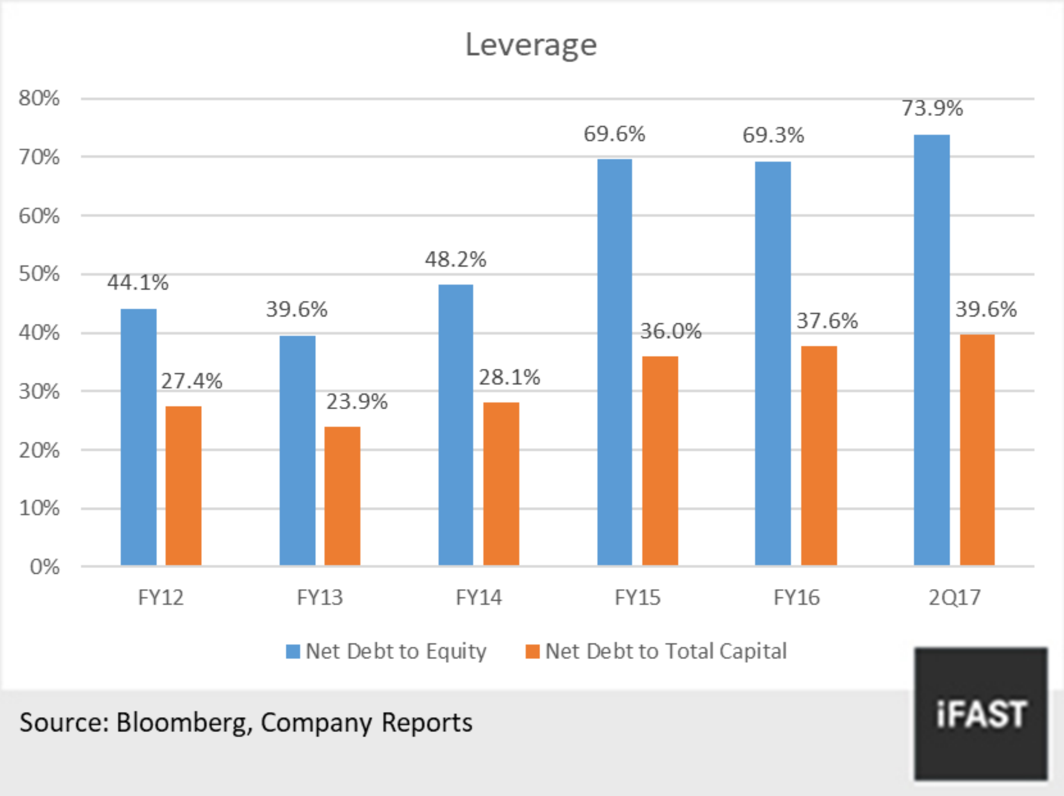
- **Pretax Interest Coverage *(Highly Leveraged)***

  BTH's headline profit before taxation in FY16 was S$710k, a large improvement from the S$19.5m loss before taxation a year ago. However, FY16 results was boosted by a S$22.8m reclassification of net fair value gains from fair value adjustment reserve in equity into other income, due to the recognition of Thai Wah PCL and Banyan Tree Indochina Hospitality Fund as associates in the year. Excluding other income and its share of results of associates, BTH's EBITDA in FY16 would be S$21.7m, 12.1% lower than FY15 (S$24.7m). Including capitalised interest of S$6.0m in FY16, the adjusted

EBITDA/interest incurred is very weak at 0.6x (FY15: 0.8x). The same measure improved to 0.9x in the twelve months ended 30 Jun 17, largely due to a 30% YoY improvement in the company's operating profit during 1H17 (S$18.9m).

- **Leverage *(Aggressive)***

Chart 1: BTH's leverage profile



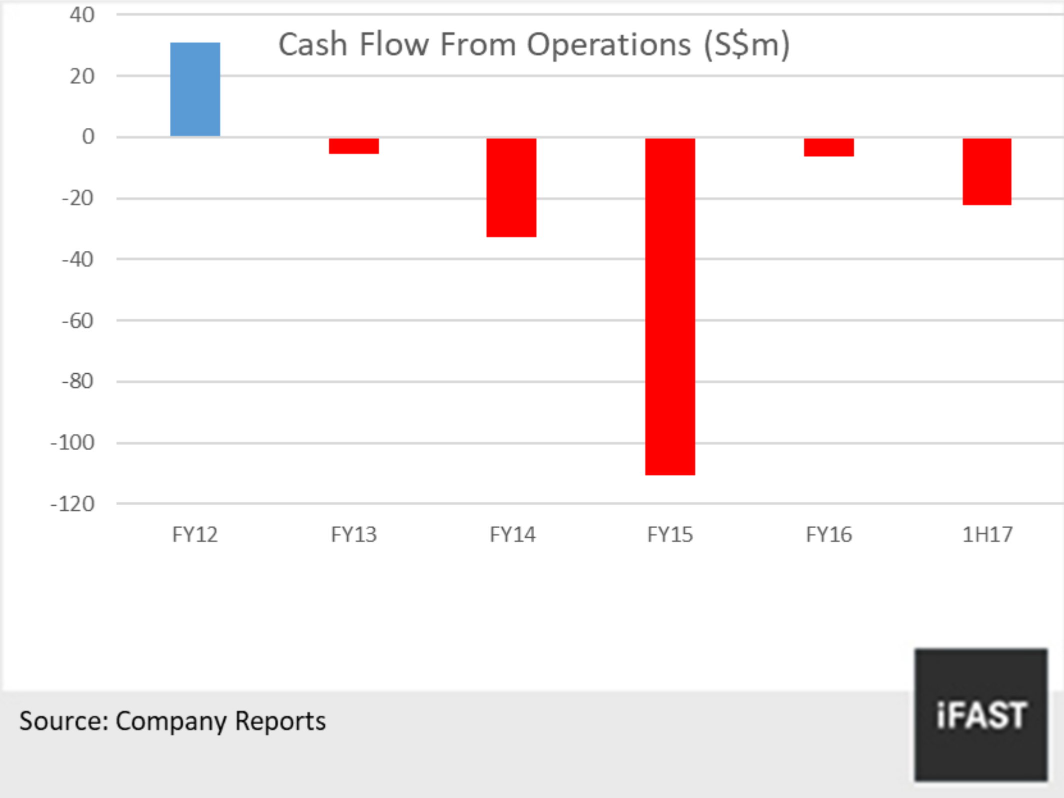
BTH's gearing has gradually climbed over the years as it funded growth plans since its IPO in 2006. The largest jump in gearing was between FY14 and FY15, when leverage as measured by debt-to-EBITDA (excluding other income and share of results of associates) and debt-to-capital went to 26.4x and 48.3% from 12.4x and 41.7%, respectively. Nevertheless, the same ratios had stabilised recently. The debt-to-EBITDA (adjusted) ratio was 22.9x in the twelve months ended 30 Jun 17 and debt-to-capital was 46.4% in 2Q17 (FY16: 28.4x and 45.7% respectively). We note that BTH's EBITDA has been inconsistent largely due to the timing of revenue recognition from property sales, which fluctuate according to project launches and completion. At the end of 2016, approximately 33% (2015: 37%) of BTH's interest-bearing financial liabilities are at floating rates of interest.

BTH's gearing should fall following its strategic partnership with AccorHotels and Vanke. BTH will receive ~S$90.1m in cash (with S$12.0m subject to post-completion adjustment) from the sale of assets into the joint venture with Vanke, and S$24.0m upon completion of the share placement to Vanke. Assuming that Accor's convertible debenture gets converted into equity and both Accor and Vanke exercise in full their options for additional shares at S$0.60/share, BTH will receive another S$90.5m of capital injection, for a total proceeds of ~S$204.7m. Under this scenario, we estimate BTH's consolidated net debt-to-equity ratio would improve considerably to ~0.4x from 0.7x in 2Q17. The impact on BTH's debt-to-capital ratio would depend on how much of the total proceeds are used to reduce existing gearing; the company's debt-to-capital would drop to ~33% (2Q17: 46.4%) if all proceeds are used to pay down debt.

- **Cash Flow *(Highly Leveraged)***

Although still loss-making, BTH's burn rate has narrowed significantly in FY16 (see chart 3). Mostly due to a reduction in property development costs, the Group's operating cash flow improved to -S$6.2m in its latest financial year from -S$110.7m in FY15. This improvement in BTH's cash flow stopped in the first six months of 2017, mainly due to progressive development costs incurred on projects in Thailand, Australia and Bintan. Net cash flow from operating activities went from S$2.1m in 1H16 to negative S$13.8m in 1H17. Net cash flows used in capex was S$5.6m in 1H17 (1H16: S$7.5m).

Chart 2: Cash flow from operations



Source: Company Reports

- **Net Assets/ Quality and Saleability of Assets *(Modest)***

  As at 31 Dec 16, freehold and investment properties, which are carried on BTH's balance sheet at fair value, amounted to S$582.4m (~89% of property, plant and equipment) and S$70.6m, respectively. Subsequent to the transactions with Accor and Vanke and subject to the assumptions mentioned earlier, we expect BTH’s debt-to-assets ratio to improve significantly to somewhere in the range of 27% to 36% (2Q17: 39%), depending on how much of the proceeds are used to pay down debt.

  BTH is tying up with Vanke to form a joint venture, Banyan Tree Assets (China) (BTAC). Under the deal, BTH's Banyan Tree-branded hotels and assets in China will be sold to the JV. The net amount of these assets stood at S$167.6m in 2Q17. Intangible assets at S$34.1m, comprising mostly of brands/trademarks, accounted for only 2.1% of total assets (S$1.59 billion) at the end of June 2017. Secured debt was S$225.1m in 2Q17 (36.1% of total debt) while encumbered assets used as collateral for such debt was S$509.0m.

- **Working Capital *(Modest)*; Liquidity *(Adequate)***

  As at 30 Jun 17, S$99.9m in short term borrowings (16.0% of total debt) will come due against cash balance of S$91.6m. BTH's current assets included S$265.1m of property development costs, against which there was unrecognised revenue (sales are recognised using the completed contract method) as at 2Q17 of S$154.0m. Approximately 30% of these property sales will be progressively recognised in the second half of 2017. BTH's current ratio (which included the assets and liabilities sold to BTAC) and quick ratio improved to 2.9x and 0.6x in 2Q17, respectively, from 2.3x and 0.5x at the end of 2016.

  BTH has completed the issuance of debenture and share options to Accor, and executed the definitive agreements with Vanke to create BTAC. BTH has also signed a share placement agreement with Vanke, and has granted options to Vanke for the subscription of additional shares in the company. These arrangements will see the Group gets S$48m in initial investments, approximately S$90.1m via disposal of certain assets into the BTAC joint venture with Vanke, and possible additional injections of ~S$66.5m from the two parties. These transactions will further improve BTH’s liquidity and working capital position.

- **Profitability *(Weak)***

  As is characterized by a business with mostly fixed costs that cannot be pared back easily during periods of weak demand, and low capacity for differentiation (hence weak pricing power), the hospitality industry has mediocre profitability and frequently has to contend with price wars. BTH's profitability in the context of its industry is worse than the average hotel operator/owner. The Group averaged a negative 0.3% ROE in the five years ended 31 December 2016, compared against the median 5-year average ROE of 4.9% of 14 hoteliers and 37 real estate developers listed on the SGX.

- **Amortization/Maturity Schedule; Capital Structure *(Fair)***

  As at 30 Jun 17, BTH has S$99.9m (16.0% of total debt) of borrowings that will be repayable in one year or less. Total borrowings that are secured by assets amounted to S$225.1m (36.1% of total debt). At the end of 2016, BTH has about S$126.7m of minimum lease payments payable under non-cancellable operating lease, of which S$14.2m is payable within a year, and S$47.6m payable between two to five years. If we include these operating lease commitments (FY15: S$138.3m) into total borrowings, we find adjusted net debt-to-equity at 0.9x (FY15: 0.9x). BTH's net gearing and capital structure should improve significantly post-completion of the deals with Accor and Vanke.

- **Negative Pledge, Financial and other Covenants *(Satisfactory)***

  The documentation for BTH's S$700m Multicurrency Debt Issuance Programme, under which its notes payables are issued, provides the following protections to the bond investors.

  Negative Pledge:
  The negative pledge in the documentation is rather weak in our opinion, as it excludes, among others, any security over any asset already existing on or prior to the date of the Trust Deed, any existing and future encumbrances to secure the indebtedness of LRH and its subsidiaries, and any security over any assets acquired after the date of the Trust Deed for the sole purpose of financing the acquisition or any refinancing thereof.

  Financial covenants:
  (i) the Consolidated Tangible Net Worth will not at any time be less than S$450m;
  (ii) the ratio of Consolidated Total Borrowings to Consolidated Tangible Net Worth shall not at any time exceed 1.9x; and
  (ii) the ratio of Consolidated Secured Assets to Total Tangible Assets shall not at any time exceed 0.7x.

  Change of control:
  The documentation does not provide change of control provisions. However, BTH has covenanted with the Trustee that so long as the bonds remain outstanding, it shall at all times, (i) own directly or indirectly through its wholly-owned subsidiaries, not less than 48% of the issued share capital of LRH; and (ii) retain management control of LRH.

  Delisting put:
  There is no delisting put provision in the programme documentation. However, BTH has covenanted that as long as the bonds remain outstanding, it will remain listed on the SGX.

  Events of Default:
  Aside from the usual non-repayment of interest and principal, winding-up of BH or any of its Principal Subsidiaries, BTH has included the disposal of material assets as an Event of Default. If BTH or any of its Principal Subsidiaries ceases or threatens to cease to carry on all or a material part of its business (except for the purpose of and followed by a reconstruction, amalgamation, reorganisation, merger, consolidation or transfer of assets to its subsidiary and such event does not or is not likely to have a material adverse effect on BTH), it will be considered as an Event of Default.

  Disposals of assets:
  BTH has further covenanted that it and its Principal Subsidiaries will not sell, transfer, lease out, lend or otherwise dispose of assets that would have a material adverse effect on it. The documentation however provides for the following exceptions, among others:
  (i) disposals made in the ordinary course of business and on normal commercial terms;
  (ii) disposals conducted on an arm's length basis, result in an increase in net tangible assets, and have been approved by the Trustee in writing;
  (iii) disposals of assets that are obsolete;

(iv) transfers of assets to a subsidiary of BTH or to any Real Estate Investment Trust, real estate property funds or any member(s) of the group where BTH would own beneficially in aggregate at least a 5% stake, provided that such transfers are conducted on an arm's length basis and do not result in a decrease in the net tangible assets of the Group;

(v) disposals of assets approved by an Extraordinary Resolution of the Noteholders.

- **Other Qualitative Factors *(Satisfactory)***

  Geographically, BTH's income is relatively concentrated in Thailand and Indian Oceania. In FY16, Southeast Asia, Indian Oceania and Northeast Asia contributed 68%, 21% and 8% of revenue, respectively. Thailand has been a relatively stable income driver, contributing 96% of operating profit from hotel investments in the latest financial year, as the political situation in the country stabilised. Revenue from Northeast Asia, of which we think China contributed most of it, has declined from 23.5% of total revenue in FY11 to 8.4% in FY16, even as credit exposure to the region stayed largely the same at 33.3% of trade and other receivables in FY16 (FY11: 32.3%). Management has attributed the decline in revenue contribution from China to price wars that are exacerbated by the country's economic slowdown.

  By operating segments, BTH's credit risk in FY16 was mostly from its property sales (53%) and fee-based segment (27%). In FY15, BTH recorded relatively large allowance for doubtful debts of S$16.3m, which was mostly due to unpaid management fees from third-party hotel/resort owners. We took comfort in the fact that provisions for doubtful debt were much lower in FY16 at S$2.4m, and this improvement should persist given the clean-up in FY15 and FY16 that reduced trade receivables to S$58.8m at the end of 2Q17 (FY14: S$101.7m). Management has guided that for its next phase of growth, the Group is targeting Europe, Africa, the Middle East and the Americas, areas where Accor already has a sizeable presence.

Industry Considerations *(Business Risk Profile)*

We see BTH's overall business risk profile as ***Fair***, considering the below analysis and factors.

- **Economic Cyclicality *(Weak)***

  The hospitality industry is nothing if not cyclical, and profitability typically correlates closely with GDP growth. Room demand is very sensitive to prevailing economic conditions, and few people would consider hotel stays as necessities. The industry is also subject to external and largely unpredictable geopolitical shocks that can throw off all previous travel and occupancy forecasts. In addition, BTH focuses on the high-end segment of leisure travellers, instead of the more reliable business travellers. Overbuilding is frequently an issue in the industry during favourable market conditions, when hoteliers have excellent pricing power. This issue is especially prominent in the luxury segments where BTH reside, and it can take several years between ground-breaking and completion—during which time the economy may have gone into reverse.

  Nevertheless, international tourism has mostly stayed robust in recent years despite the challenges. The World Tourism Organization (UNWTO) in January reported that international tourist arrivals grew by 3.9% to reach a total of 1,235 million in 2016, which was the seventh consecutive year of expansion following the 2009 global financial crisis. UNWTO highlighted that the industry has not seen a comparable sequence of such uninterrupted solid growth since the 1960s.

- **Growth Prospects *(Satisfactory)***

  According to the Global Hotel Review published by STR Global, hotels in the Asia Pacific region reported mixed performance in 2016. Occupancy in the region increased 1.6% YoY to 69.0% and RevPAR improved 0.6% to USD69.34, but average daily rate declined 0.9% to USD100.46. Taking a global perspective, we think the overall renewed consumer confidence, along with a shift in household spending from goods to services and experiences, should help the industry to sustain a growth rate higher than GDP.

  Notwithstanding the recent troubles with BTH's operations in China, we think the improvements in both Chinese domestic and outbound tourism are likely to be sustainable in the near to medium term. According to data from UNWTO, 2016 was another strong year for outbound tourism from China, the world's leading outbound market. The number of outbound travellers rose 6% to 135 million in 2016, and they spent around USD261bn, an increase of 12%. Meanwhile, the China National Tourism Administration said in January that the country's domestic tourism industry earned about RMB3.9tn (~USD563.6bn) in 2016, representing a 14% YoY growth. Domestic tourists made 4.44 billion trips last year, an 11% percent increase from 2015.

- **Competition *(Vulnerable)***

  A high proportion of total costs in the hotel business is made up of fixed costs, i.e. the marginal costs of adding a traveller are low relative to the fixed costs of maintaining the premise. Theoretically, this should provide capacity for economies of scale and competitive advantages to the larger and more successful hoteliers. However, we think the minimum efficient scale in the industry is likely to be miniscule relative to the market size (think of the landlords on Airbnb who can make a living with just one apartment/unit), thus eliminating the benefits of larger hotel operations.

  Historically, BTH has tried to differentiate itself by focusing on the high-end segment. Unfortunately, the luxury segment of the hotel and resort industry is subject to intense competition for guests, the acquisition of new properties, the entry into new hotel management agreements and the continuation and renewal of existing hotel management agreements. Management suggested in BTH's 2016 annual report that "excellent brand equity has been the bedrock of our success to date. Our success has always been due to the distinctive character of our brands, the authentic and memorable experience of stays at our properties, and the socially conscious ways in which we do business." However, we have not seen any evidence of these "distinctive" brands translating into sustained profitability for the company.

  BTH has entered into the mid-market segments starting in 2015 when it opened its first Cassia-branded service apartment. We do not foresee this move as likely to portend a better future for the company, as the mid-market and budget segments are facing increased competition from other alternative accommodation options such as Airbnb which may offer more attractive rates for guests.

  Lastly, the emergence of online booking platforms may further threaten the source of singularity in the hospitality industry. The future of the industry may be one where increasingly the pricing power shifts to these platforms, which provide ease of comparison for the main criteria of choosing a hotel—its location, price and user reviews.

- **Research and Development/ Technological Changes *(Fair)***

  The travel landscape has been undergoing a frenetic pace of disruption in recent years, as online private accommodation aggregators inundate the marketplace with new inventory. In addition, disrupters like Airbnb compete head-to-head with hotels in certain segments of the market. Hoteliers must try to remain vigilant and be responsive to change. The tie-up with Accor may help BTH to obtain lower commission rates on online booking systems, due to larger scale of operations, allowing it to compete more effectively. BTH does not disclose its budget that is allocated to research and development. The significant improvement in free cash flow in 2016 is due in large part to reduced capital expenditures, and capex is likely to go up in the near term.

- **Degree of Regulation/ Government Influence *(Satisfactory)***

  BTH's hospitality business operations is subject to the applicable national and local government regulations in the locations in which it operates, including those relating to the relevant licensing requirements in relation to resorts, hotels and spas. Local laws, licensing requirements and regulations include health and liquor licensing laws and laws and regulations governing relationships with employees in areas such as minimum wage and maximum working hours, overtime, working conditions, hiring and terminating of employees and work permits. BTH's spa treatment products are also subject to local health regulations. In addition, there are certain capital requirements applicable to its subsidiaries in Thailand and China. BTH is required to set aside a statutory reserve of at least 5% and 10% of its net profit until its capital reserve reaches 10% of the registered share capital of its subsidiaries in Thailand and China, respectively. Nevertheless, there is no evidence that the company has been facing excessively high costs of compliance, or that it is unable to pass the costs on to customers or other stakeholders.

  Property sales in Chengdu have been temporarily halted due to the local government’s inability to provide vital infrastructure (water, power, sewerage and gas) to the project site by time of delivery of the first apartments. lack of provision of infrastructure (water, power, sewerage and gas) by the government. BTH has disclosed that it is in discussions with the Wenjiang government to resolve this situation. The recent tie-up with China Vanke Co., Ltd should facilitate with the revival of this project.

- **Labor *(Satisfactory)***

In February 2009, BTH's hotels in Laguna Phuket were confronted with the illegal assembly of around 150 staff, their blockage of public roads and infringement of private property. The incident arose as a result of several Laguna Phuket hotel unions not accepting their year-end bonus awarded to the employees. Management reported that the disruptions had no significant impact on BTH's financial results.

According to the disclosures in its debt issuance programme documentation, a majority of BTH's employees are based in Thailand, whose labour laws are highly protective of employees. Thai labour laws generally prohibit companies from discharging employees without severance payments and/or compensation in the absence of gross misconduct, neglect, or acts of dishonesty. In addition, any changes to employment terms and conditions that diminish employees' rights and benefits would require consent from employees. As such, BTH has limited measures at its disposal to reduce headcount in order to increase efficiencies, reduce costs or achieve similar objectives. In the aftermath of the global financial crisis in 2009, BTH instituted a voluntary unpaid leave programme in March 2009 as it was unable to lay off employees without compensation.

Turnover of the senior management team has been observedly low. Key management personnel such as Mr Ho KwonPing, Ms Claire Chiang, Mr Ho KwonCjan, Mr Eddy See Hock Lye and Mr Shankar Chandran have been instrumental in the development of BTH since its early days.

- **Accounting *(Strong)***

No red flags observed. BTH has been generally conservative in applying accounting rules. Revenue from property sales is recognised using the completed contract method, which is normally on unconditional exchange of contracts and the significant risks and rewards of ownership of the property have been transferred to the buyer. BTH won the Most Transparent Company Award—Mainboard Small Caps, Runner Up in the SIAS Investors' Choice Awards 2016, and the Silver Award for Best Annual Report under the Mid-Cap Category in the Singapore Corporate Awards 2016.

- **Event Risk *(Excellent)***

Management BTH recently clinched two important strategic partnerships with Accor and Vanke, which were first announced on 8 December 2016 and 23 January 2017 respectively. Early last month, BTH completed the issuance of the S$24m convertible debenture to Accor and granted an option to Accor to subscribe up to 10% of BTH shares (taking into account the shares to be issued to Vanke). Shortly thereafter, BTH executed the definitive agreements to create BTAC and the share placement agreement with Vanke. We view these events as substantially credit positive.

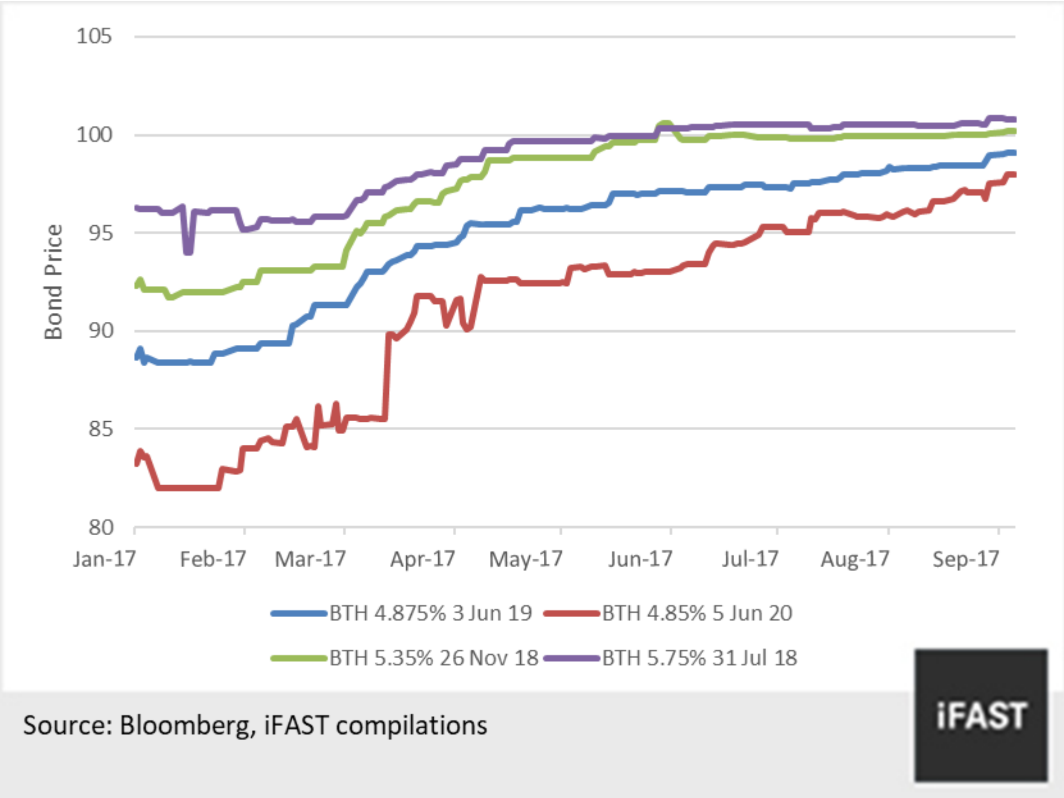
Collectively, Accor and Vanke will be investing S$48m in BTH initially via the debenture and share placement respectively. The S$24m invested by Accor through the mandatory convertible debenture will give Accor a ~5% stake in BTH. Under the share placement agreement, Vanke will pay S$24m for a 5% equity stake in BTH, at a placement price of S$0.60/share. In addition, BTH has formed a joint venture BTAC with Vanke. Under the deal, BTH's China-based assets were sold to BTAC at a consideration of around S$90.1m (with S$12.0m subject to post-completion adjustment).

The two transactions will also grant Accor and Vanke options to purchase additional new equity in the company, at an exercise price to be determined at a later date. The maximum aggregate number of shares to be issued to the two companies is capped at 95,433,507 shares each (~10% of the enlarged share capital of BTH). Assuming Accor and Vanke both exercise their options in full at a price of S$0.60/share, which is the automatic trigger conversion price of the debentures issued to Accor, BTH may raise an additional ~S$66.5m, and the two companies would each hold a ~10% stake in BTH. Under these assumptions, we estimate BTH's consolidated net debt-to-equity ratio would improve considerably to ~0.4x from 0.7x in 2Q17. Finally, both Accor and Vanke will each nominate one director to the board of BTH. We view this as a positive signal of long-term collaboration and strategic partnership to develop and manage Banyan Tree branded hotels around the world.

Bond Pricing and Recommendation

The BTH bonds have all posted a strong rally since early February, after the announcement of the strategic partnerships with Accor and Vanke (see Chart 3). The price of the two shorter dated bonds—BTHSP 5.750% 31Jul2018 Corp (SGD) and BTHSP 5.350% 26Nov2018 Corp (SGD)—have appreciated to the extent that they are now trading above par.

Chart 3: The BTH bonds have outperformed strongly this year.



We think that at current pricing (see table 1), the market has already factored in most if not all of the positives from BTH's two deals with Accor and Vanke. As such, we assigned a Neutral rating on all four of the Banyan Tree bonds. On a relative-value basis, we would lean toward the BTHSP 5.350% 26Nov2018 Corp (SGD) and BTHSP 4.850% 05Jun2020 Corp (SGD). In exchange for extending the maturity for four months, the BTHSP 5.350% 26Nov2018 Corp (SGD) offers a decent spread pickup of ~31bps over the BTHSP 5.750% 31Jul2018 Corp (SGD). Given that we see BTH's issuer profile as Positive and its credit fundamentals to improve in the near-to-medium term, we would also advocate going for the longer dated BTHSP 4.850% 05Jun2020 Corp (SGD), which is trading below par and have some potential for capital gains.

Table 1: Comparing the Banyan Tree bonds.

Security Name	Maturity	Outstanding Amount (SGD mn)	Ask Price	Ask YTW (%)	Z-Spread (Ask; bps)	Credit Opinion
BTHSP 5.750% 31Jul2018 Corp (SGD)	31-Jul-18	70	101.109	4.448	336.402	Neutral
BTHSP 5.350% 26Nov2018 Corp (SGD)	26-Nov-18	50	100.615	4.812	367.626	Neutral
BTHSP 4.875% 03Jun2019 Corp (SGD)	3-Jun-19	125	99.700	5.054	382.348	Neutral
BTHSP 4.850% 05Jun2020 Corp (SGD)	5-Jun-20	100	98.767	5.338	395.265	Neutral

Source: Bloomberg, iFAST compilations

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